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SUBJECT: Economic Downturn Takes Guangdong's Recycling Industry for a Loop

1. (U) Summary. In this economy, even the recycling industry is getting "trashed." For much of the last decade, Guangdong's recycling sector has boomed, but the global economic downturn is hurting the industry, leaving many firms struggling to stay afloat. A combination of declining consumption and dwindling profit margins has caused many of Guangdong's recycling enterprises to either drastically reduce scrap import volumes or shutdown operations completely. Some industry leaders, however, are confident that a strengthened government commitment to the environment, better understanding of the value and importance of recycling, a future increase in domestic market demand and the growth of corporate social responsibility campaigns will carry the industry through the financial storm. End Summary.

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Big Business in Guangdong  
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2. (U) Guangdong Province has been at the forefront of China's recycling industry. Driven by resource shortages and environmental degradation, the Central Government has placed a high priority on expansion of the industry, making China the world's largest importer of waste. Importing waste mostly from U.S. and European markets, Guangdong ranks number one among China's provinces in imports and processing of scrap non-ferrous metals, such as copper and aluminum. Guangdong's Nanhai City alone account for 15% of China's scrap metal imports. Guangdong supplies scrap metal, paper, and plastic to over 1,000 international and domestic companies throughout China looking to cut costs and/or promote environmental protection, including Toyota, Procter and Gamble, and Foxconn. In 2007, the province's recycling industry brought in well over RMB 12 billion (USD 1.8 billion).

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Price Drops, Profit Shrinks  
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3. (U) After years of rapid growth, the industry is now suffering due to a declining global demand for consumer goods and raw materials and, as a result, falling commodity prices. Recycling firms are most concerned about the demand for scrap metals, the most profitable material, followed by paper and plastic respectively. As resources traded on the commodities market, metals are highly sensitive to market fluctuations. Ironically, much of the falling global demand is in direct response to China's domestic market,

which stands as the top global consumer of copper, and metals used in packaging and infrastructure.

¶4. (SBU) Lower demand leads to lower prices, and the falling price of scrap metal has caused many Guangdong enterprises to lose money on contracts signed earlier in the year. According to Chairman Li Yuanfeng of Guangzhou Wanluda Group, a major producer of recycled materials located in Guangdong's Nanhai City, it's standard practice for recycling enterprises to sign contracts with exporters three months to one year prior to the delivery date. Most importing firms also have to pay a 20% down payment. But sharp price drops forced many companies to cancel contracted orders. Chen Jiehong, Secretary General of Nanhai Recycling Business Association, explained that prices for both copper and aluminum scrap reached a historic peak at RMB 82,000 per ton in 2007. By September 2008, the price dropped to RMB 58,000 per ton, and another 60% to RMB 20,000 by October 2008, the height of the crisis. Most companies are only able to recover 60% of their down payment when they cancel an order. For other companies, the alternative was to negotiate a discounted rate with exporters, requiring full payment upfront, with no guarantee that the value of the scrap will not drop again before delivery.

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Suspending Operations  
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¶5. (SBU) Sharp price drops have also led to wide-scale suspension of operations, according to Chen. Most companies have halted at least a portion of their processing, including Nanhai's largest recycling enterprise, Huimei Hongfa, because they are not able to move inventory or make a profit. Buyers are simply unwilling to pay the pre-downturn price. Guangzhou Wanluda's Chairman Li pointed out

that because the dramatic declines in commodity prices have made profit margins so thin, he decided to reduce his company's inventory to the lowest level possible to minimize risk. Chen told us that several managers have stopped importing scrap, and are taking a 'wait-and-see' attitude toward the market until after the Chinese New Year.

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Aiming to Be Green  
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¶6. (SBU) The Chinese government has enacted an extensive system of regulations intended to ensure that the recycling industry enhances environmental protection in south China. According to Chen, potential scrap material imports are categorized into a three-tier system: 1) 'not permitted,' including heavy-polluting items such as electronic waste and computer parts, 2) 'automatically approved,' which include items that do not pose a serious threat to the environment, and 3) 'need to be reported and approved.' Many enterprises in Guangdong import scrap materials that fall under the 'needs approval' category. For these, the Central Government approves each enterprise's shipment requests prior to import, specifies which ports can receive such shipments, and controls where and how the scrap material is processed. Chen also noted that the regulations require enterprises to use recycled water in the production process; even rain water at the recycling facility must be collected and treated before it is released. In addition, local enterprises are not permitted to import more than 5% of non-recyclable scrap as a part of any given shipment.

¶8. (U) Additional steps are taken in Nanhai with its heavy concentration of recycling enterprises. The Nanhai Recycling Business Association operates waste collection stations; waste is subsequently used at local garbage power plants. Useless waste is separated into hazardous, industrial and domestic waste categories, and taken to landfills. (Note: Our contacts were reluctant to elaborate on the volume of waste dumped at landfills and relevant environmental safeguards applied to that waste. End note.) Local enterprises take additional steps to prevent noise pollution and excess air pollution caused by dust created during scrap processing. Local government also conducts annual audits, during which a company must score 80% in order to remain in operation. Enterprises that pass must also undergo a secondary audit.

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Future Projections: Growth in the Industry  
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¶9. (SBU) The most significant challenge that legitimate recycling enterprises face is fighting the temptation to prioritize profit over environment, according to Guangzhou Wanluda's Li. He commented that it was relatively easy for enterprises to ignore local environmental laws, some operating completely illegally in Guangdong, because local officials do not have the capacity to effectively regulate or monitor the recycling industry. Illegal operations are more profitable as management often cuts corners, dumps polluted waste, and in general fails to adhere to often costly environmental regulations. Li told us that many environmentally-friendly practices, such as treating solid waste in compliance with local law, are costly and decrease profit margins.

¶10. (SBU) Looking toward the future of the industry, Chen said 'the future is bright, but the road has twists and turns.' Wanluda's Li adds that the foundation of the recycling industry in Guangdong is changing. According to Li, business-owners initially got into the business to make quick money. Now, the industry is attaching more importance to environmental protection and linking with corporate partners to promote corporate social responsibility (CSR). Local government also supports the industry through assistance with land acquisition and funding subsidies. Li predicts that in light of the 11th Five-Year Plan, and Premier Wen Jiaobao's "Pollution Prevention and Energy Efficiency" taskforce, it will become more and more mainstream for both domestic and foreign companies to utilize recycled material. However, he acknowledged that the recycling industry has a long way to go and that foreign media and other international actors will need to continue raising awareness about the benefits of recycling.

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